OCTOBER 13, 1980

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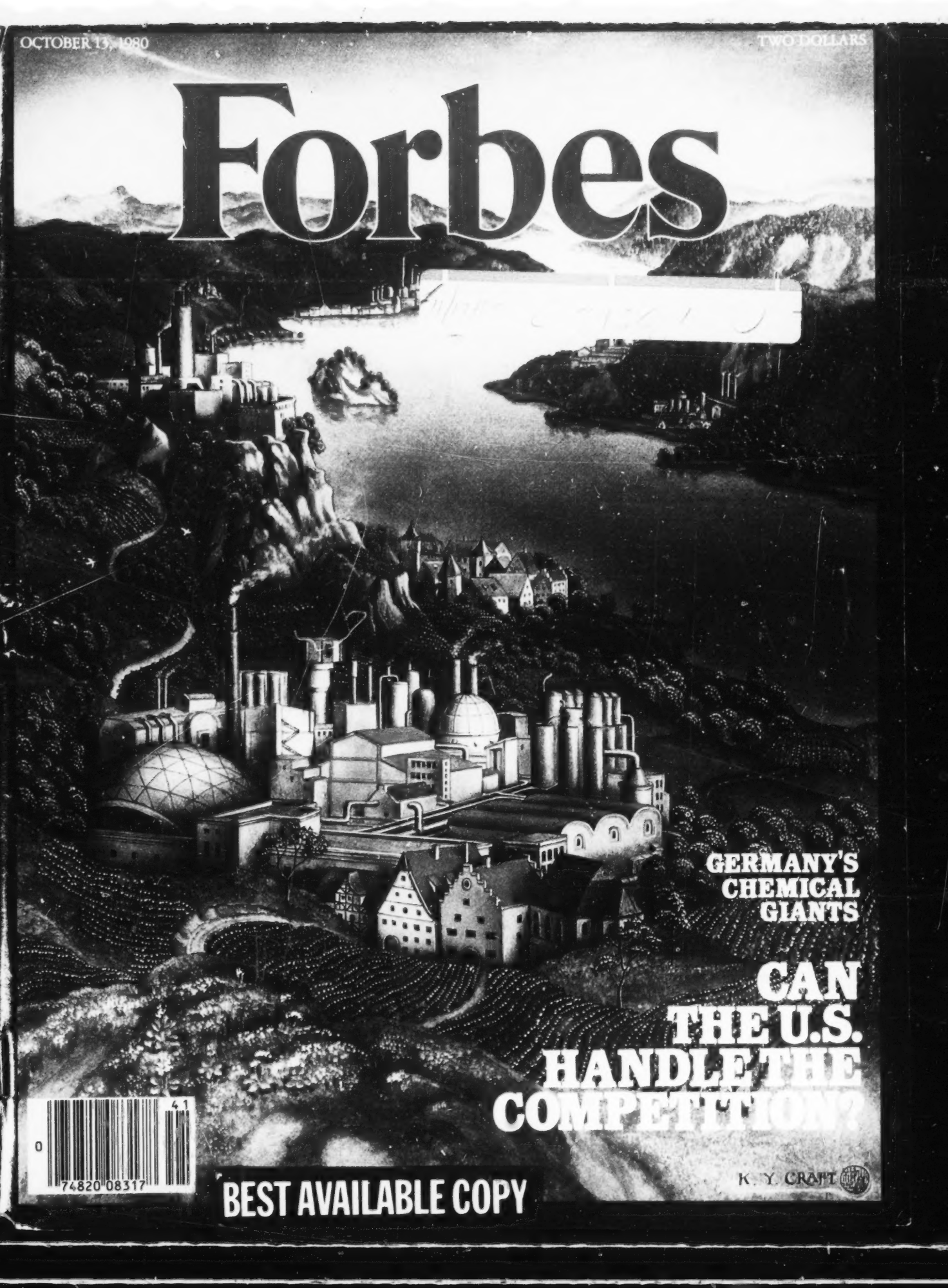

GERMANY'S CHEMICAL GIANTS

CAN THE U.S. HANDLE THE COMPETITION?

K. Y. CRAFT

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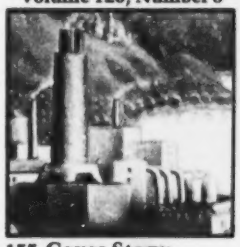
Forbes

October 13, 1980
Volume 126, Number 8



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Premiums for growth stocks are getting heady again. Has the time come for caution?

What price growth?

EACH MONTH THE FIRM of Kidder, Peabody publishes a list of the 50 Big Board stocks with the highest price/earnings ratios—The Nifty Fifty. Last month the median P/E for the list was 18 *(see chart below)*. If this was still a long cry from the 50-plus median P/Es of 1973, it was also a good move up from the median 13 times earnings that prevailed as recently as November 1979. Last month, Kidder's Nifty Fifty sold at a median P/E that was about twice that of the Standard & Poor's 500, making the premium for growth-glamour about 100%. Way back in the wild days of 1973, the premium had been over 200%.

Clearly, however, growth is back in favor. Over the past year, the September 1979 Nifty Fifty has gained an average 28% in price, while the Dow Jones industrials were up only 5%; a couple of stocks on the Kidder list have doubled.

Where has the action been concentrated? Almost entirely in three areas: high technology (21 of the 50), energy (14 of the 50) and health care (7 of the 50).

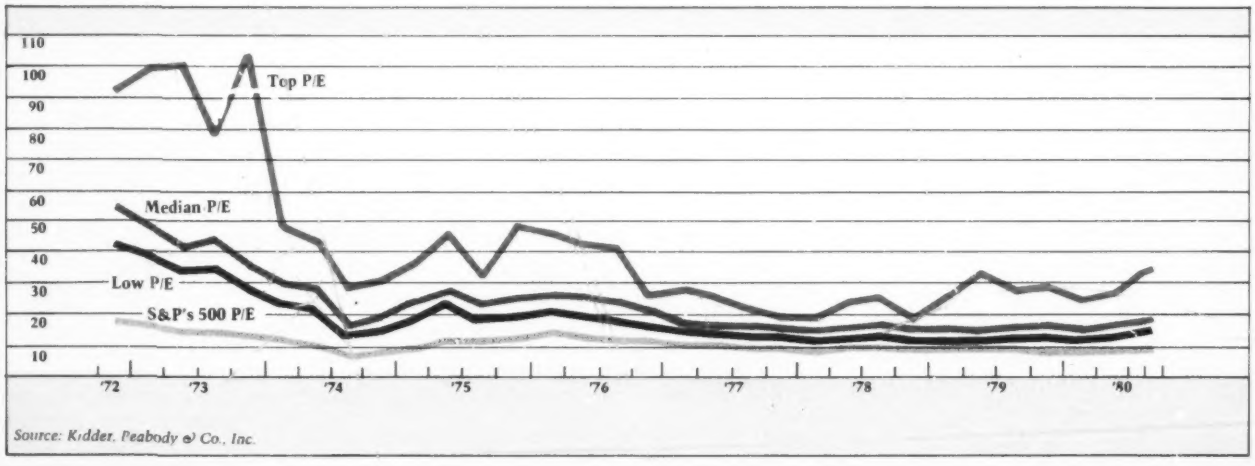
Are the premiums for growth getting out of line again? It's nothing like the late Sixties or early Seventies, but you can make a case that the prices are a bit dizzy. As a group these stocks earned an average 21% on their net worth *vs.* 15% for the averge Big Board stock. But is a 40% premium in profitability worth a 100% premium in P/E? Certainly there is a degree of risk in paying 18 times earnings or more for a stock. Such stocks are vulnerable to factors that might not hurt the ordinary issue—a slowdown in earnings growth, for example. If your ordinary stock has, say, flat earnings or even a modest decline, the stock may not suffer—it is expected. But a Nifty Fifty can be almost destroyed if its earnings growth drops, let's say, from 30% to 10% in a given quarter—that's *un*expected. If for one reason or another the market decides to lower the P/E premium, a slower stock can be literally decimated.

Remember the old Nifty Fifty? Avon Products, for example, was a star. It has almost doubled its earnings since 1973. Yet the stock currently sells for less than 30% of its 1973 price. Its multiple was sharply downgraded. Capitalized at more than 50 times earnings in 1973, the stock is currently capitalized at less than 9. That can happen to any high P/E stock. Let its multiple drop from Nifty Fifty levels down to average levels and you can lose most of your money, even if the company continues to do well.

Can The Nifty Fifty go higher? Of course, it can, but it's getting riskier every day. Mark this well: When you pay 18 times earnings for a stock, the earnings yield is just 5.5%—that's *earnings* yield, not dividend yield. Even if earnings double over a few years the yield is still only 11%. How good a buy is this when government-guaranteed bonds yield as high as 13%? ■

After the fall

The recent strength in the stock market notwithstanding, investors are still a long, long way from the wretched excess they were capable of in the early 1970s. Price/earnings ratios, while up substantially from their lows, are not surreal.



Source: Kidder, Peabody & Co., Inc.

The Nifty Fifty, September 1980

Will this month's Nifty Fifty *(below)* outperform the market as last year's did? Maybe so, maybe not. This kind of stock can be very volatile, depending not only on earnings progress but also on the multiple that investors put on those earnings. What happens depends in good part on how investors feel about paying a premium for growth. Right now they feel pretty good about it: P/Es are higher than they have been in years. They are, however, still far below those of the early 1970s. The obvious dilemma: Is a "correction" due, or is there still more room for price rises?

Company (industry)	Recent price[1]	Recent price/ earnings ratio[1]	P/E ratio range 1970 to present	Earnings per share — latest fiscal year	Earnings per share — latest 12 months	Earnings per share — fiscal 1980-81 estimates	% earned on net worth 1979	% earned on net worth 1970 to present average
Computervision (computers)	45⅝	34	63– 4[2]	$1.05	$1.34	$1.45	31.9%	8.2%[2]
M/A-Com (precision instruments)	41⅜	33	33– 4	0.99	1.26	1.35	16.4	10.9
•**Rolm** (computers)	36¼	33	50– 7[2]	1.09	1.09	1.40	34.5	27.5[2]
•**Prime Computer** (computers)	36¾	29	38– 7[2]	0.96	1.29	1.35	38.2	17.7[2]
Scientific-Atlanta (electronics)	38½	29	53– 3	1.31	1.31	1.60	15.2	11.2
•**Gearhart Inds**[3] (oilfield services)	37¼	28	28– 3	1.13	1.33	1.70	19.4	17.2
FlightSafety Intl (training services)	29¾	26	41– 3	0.96	1.15	1.20	22.5	18.7
•**Helmerich & Payne** (oilfield svs)	72	21	22– 6	2.63	3.42	3.70	17.5	14.6
New England Nuclear (specialty chems)	30¼	21	42– 7	1.36	1.43	1.65	15.9	14.9
•**Schlumberger** (oilfield services)	133⅛	21	55–11	5.18	6.26	6.80	27.4	20.2
Veeco Instruments (electronics)	33¼	21	31– 3	1.54	1.62	1.85	25.1	14.4
•**Datapoint** (computers)	74¾	20	29– 3	3.81	3.81	4.70	19.7	neg
•**Hospital Corp of America** (health-care svs)	45¾	20	75– 3	2.03	2.35	2.60	14.1	13.3
Tymshare (computer services)	67¾	20	56– 6	3.06	3.46	3.65	20.6	15.8
•**Automatic Data Proc** (computer svs)	48⅝	19	90–13	2.49	2.49	2.95	18.9	16.6
•**EG&G** (electronics)	33⅞	19	93– 7	1.57	1.79	1.80	25.3	14.7
Fluor (engineering & construction)	46¾	19	58– 5	2.01	2.42	2.70	21.9	15.1
•**Humana** (health care)	53¼	19	48– 3	1.98	2.80	3.00	17.4	11.7
Parker Drilling (oilfield services)	52⅝	19	85– 4	2.79	2.81	2.95	19.6	15.4
•**Teleprompter** (cable TV)	23⅜	19	87–10	1.14	1.22	1.35	15.8	3.1
•**Waste Management** (industrial svs)	69⅞	19	46– 4[2]	3.10	3.59	4.00	18.7	15.1
Western Co of NA (oilfield services)	34½	19	105– 1	1.20	1.78	2.20	16.9	19.0
•**Baker International** (oilfield equip)	35¼	18	38– 8	1.63	1.92	2.05	17.8	16.8
Perkin-Elmer (precision instr)	58⅛	18	56–10	3.34	3.34	3.75	17.8	12.6
•**Rowan Cos** (oilfield services)	31	18	21– 3	1.33	1.75	2.35	17.4	15.2
•**Beckman Instruments** (precision instr)	31	17	43– 7	1.83	1.83	2.05	15.9	9.7
•**Big Three Industries** (industrial gases)	58¾	17	26– 9	2.98	3.50	3.75	15.6	14.6
•**Data General** (computers)	83⅞	17	91– 6	4.82	4.93	5.55	19.8	16.7
•**Hewlett-Packard** (precision instr)	71¼	17	63–12	3.43	4.08	4.20	16.4	14.2
Keystone Intl (industrial valves)	28½	17	17– 3	1.50	1.68	1.80	25.9	25.3
Mohawk Data Sciences (computer svs)	26¾	17	85– 4	1.53	1.61	1.85	17.8	neg
Sanders Associates (electronics)	45¾	17	49– 6	2.65	2.65	3.25	22.1	neg
Advanced Micro Devices (electr)	51¼	16	43– 3[2]	2.94	3.18	3.30	26.6	14.1[2]
American Medical Intl (health-care svs)	48⅝	16	52– 3	2.59	3.04	3.20	17.6	11.0
Augat (electronics)	31⅝	16	49– 7	1.86	1.92	2.05	24.1	22.6
•**Digital Equipment** (computers)	85½	16	81–10	5.45	5.45	6.25	15.9	13.2
•**Dun & Bradstreet** (publishing)	53¾	16	31– 9	3.19	3.42	3.50	26.6	21.4
Cameron Iron Works (oilfield equip)	43	16	24– 5	2.61	2.61	3.25	18.3	16.7
Geosource (oilfield services)	82¼	16	16– 6[2]	3.66	5.24	5.00	18.3	15.2[2]
Global Marine (oilfield services)	45½	16	57– 3	2.11	2.86	3.05	22.5	7.5
Halliburton (oilfield services)	118⅛	16	39– 8	6.42	7.25	8.10	16.8	17.3
Handy & Harman (precious metals)	59¾	16	45– 3	2.03	3.71	3.15	15.6	15.2
•**Harris Corp** (machinery)	41⅝	16	30– 4	2.63	2.63	2.95	18.2	11.6
Loral Corp (electronics)	30⅞	16	36– 1	1.84	1.91	2.10	24.2	14.5
•**Medtronic** (health care)	41⅛	16	72– 6	2.52	2.63	3.15	17.2	15.7
Natl Medical Care (health-care svs)	39¾	16	71– 3[2]	2.15	2.41	2.65	23.7	13.9
Natl Medical Enterprises (health-care svs)	43⅜	16	32– 2	2.74	2.74	3.40	12.1	10.0
Tandy Corp (consumer electronics)	70	16	35– 3	4.47	4.47	5.35	40.0	23.2
Viacom International (broadcasting)	48⅜	16	53– 3	2.48	2.94	3.25	20.3	12.0
•**Wal-Mart** (retail)	48¼	16	50– 6	2.68	2.97	3.25	25.0	22.3

• Company also appears on The Nifty Fifty, September 1979 list from Kidder, Peabody (see table, p. 86). [1] The calculation for the price/earnings ratios for the Kidder, Peabody Nifty Fifty list are based on the closing market price on the last trading day of the preceding month and the most recent 12-month earnings. Recent price is the price at the end of August 1980. [2] Data shows range for period shorter than ten years. [3] Formerly Gearhart-Owen Industries. neg: negative

Sources: Kidder, Peabody & Co., Inc.; Standard & Poor's; FORBES

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Gold prices have started to move up again. Should investors consider gold futures?

THE BAD NEWS BAROMETER

By Stanley W. Angrist

MY READERS steadfastly refuse to send me any easy questions. The one thing that seems to be on their minds right now is how the outcome of the presidential election will influence precious metals' prices. As regular readers of this column know, I am not a big fan of the precious metals, primarily because I found I had to sleep at night. It's a trade-off I resigned myself to a long time ago. Ah, but I am begging the question.

During the past couple of weeks gold and silver have started to move up again in a rather convincing manner. There are a number of reasons that have been put forth for this move: 1) Saudi Arabia raised the benchmark price of crude about $2 per barrel; 2) Carter has pulled even with Reagan in the polls, raising fears that he could win the election and restore our economy to his "normal" 18% inflation rate; or 3) Reagan will prevail in the election and restore U.S. currency to a gold standard, thus increasing the demand for gold; or 4) the Federal Reserve Board has lost control of the money supply again, thus dooming us to another bout of unchecked inflation. Of course, not all of these reasons are mutually exclusive, and some traders believe that more than one could be operating at this time. However, now that I have listed them I feel it incumbent to comment on them.

The question raised by the Saudis' latest oil price increase is whether they can make it stick in a time of world oil glut. My guess is it will be difficult.

Carter could indeed patch the Democratic coalition together one more time and pull off an election victory. Would he inflate the economy with the same zeal and vigor he did during his first four years? Being an optimist, I am inclined to doubt it, but it is certainly within the realm of possibility.

A Reagan victory is certainly no guarantee that we would return to a gold standard, regardless of the Republican platform. In the long run, Reagan would probably reduce the growth of the federal budget and this would have a negative effect on gold prices. And the passage of the Kemp-Roth tax reduction bill would certainly cloud this scenario.

People who watch the week-to-week fluctuations of the money supply figures are akin to those folks who keep track of who is ahead in first downs in a football game. It certainly is some indication of what is going on, but it is a long way from telling you who the winner might be.

So where does that leave us? As always we are faced with the fundamentals of supply and demand. Consolidated Gold Fields, Ltd. has prepared an extremely comprehensive report on gold written by David Potts, a gold analyst in its mining division. Presented below is a portion of its supply/demand balance for the previous ten years. It is evident that even in the face of higher prices noncommercial mine production has shown a marked decline, while official sales have steadily risen. (Official sales are those made by governments, such as the U.S. Treasury and the International Monetary Fund.)

The second part of the table shows how gold has been used over the past ten years. In 1979 purchase for investment (or hoarding, if you prefer), which includes by my reckoning medals, fake coins, official coins and other forms of bullion investment, amounted to 733 metric tons. It doesn't take a statistical wizard to see that last year there was a 56% increase in that area. Other industrial uses include carat jewelry (the biggest use), electronics, dentistry and miscellaneous. More than 43% of last year's gold supply wound up being bought by people who no longer trusted paper currency.

Gold is a demand-oriented commodity. It needs fresh news (or as some would say, fresh fears) to spark additional hoarding. Unfortunately, the world has not lacked for things to worry about in recent years. Still, I cannot in good faith recommend the purchase of gold futures contracts—they are just too volatile.

Investors who wish to own gold to protect themselves against the ravages of inflation might be better off putting a small portion of their portfolio into good-quality gold-mining stocks during periods of price weakness or, for the nonincome oriented, purchasing Krugerrands or similar gold coins on a cash basis. Leave the gold and silver futures market to the very high rollers. ■

The gold picture

Though the world's gold supply has grown by 70% over the past ten years, the amount of gold that went into investment and hoarding has gone from a disbursement of 241 tons in 1970 to an accumulation of 773 tons.

Gold Supply (metric tons)	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Non-Communist world mine production	1,274	1,236	1,184	1,121	1,007	954	969	972	980	962
Net trade with Communist bloc	(3)	54	213	275	220	149	412	401	410	229
Net official sales or (purchase)	(236)	96	(151)	6	20	9	58	269	362	574
Net private purchases	1,035	1,386	1,246	1,402	1,247	1,112	1,439	1,642	1,752	1,765
Gold Use* (metric tons)										
Industrial uses	1,276	1,282	1,240	785	441	711	1,152	1,227	1,258	992
Investment & hoarding (sales)	(241)	104	6	617	806	401	287	415	494	773

*Non-Communist.

Data supplied by Consolidated Gold Fields, Ltd.

Stanley W. Angrist is a professor at Carnegie-Mellon University and the author of Sensible Speculating in Commodities.

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